BEFORE THE FEDERAL COMMUNICATIONS COMMISSION
FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE
Washington, D.C. 20554

In the Matter of	)	
	)	WC Docket No. 05-337
Merits of Using Auctions to Determine	)	CC Docket No. 96-45
High-Cost Universal Service Support	)	

OPENING COMMENTS
OF THE
MONTANA TELECOMMUNICATIONS ASSOCIATION
OREGON TELECOMMUNICATIONS ASSOCIATION SMALL COMPANY COMMITTEE
AND
WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION

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INTRODUCTION

The Montana Telecommunications Association, the Small Company Committee of the Oregon Telecommunications Association and the Washington Independent Telephone Association (collectively the "Northwest Associations") are pleased to join together to provide these Opening Comments in response to the Federal-State Joint Board on Universal Service ("Joint Board") Public Notice seeking comments on the merits of using auctions to determine high-cost universal service support. The Northwest Associations are predominantly comprised of companies that qualify as rural telephone companies as defined by the Telecommunications Act of 1996.[1] These companies serve primarily very rural areas that are characterized by low subscriber densities, long loop lengths and a high cost per customer to serve. It should also be noted that the companies that are members of the Northwest Associations are companies which are in the forefront of deploying broadband technologies in rural areas. The members of the Northwest Associations that are participating in these Opening Comments are set out in Appendix A.

OPENING POSITION

The concept of reverse auctions is proposed as a means of reducing or limiting the growth of high-cost funding. The Northwest Associations agree that this is a laudable goal, particularly as it focuses on limiting multiple eligible telecommunications carriers (ETCs) in a given service area. However, the concept of reverse auctions carries with it numerous unanswered questions.

The initial reaction of the Northwest Associations is that there appear to be a number of

[1] 47 U.S.C. §153(37).

practical problems related to implementation of a reverse auction concept, not the least of which is how such a concept could continue to provide for the advancement of broadband services in rural America. The Northwest Associations will carefully consider the Opening Comments filed by other parties before taking a final position. However, at best, the Northwest Associations are uncertain that a reverse auction concept can be successfully deployed.

As the Joint Board notes in paragraph 3 of the Public Notice, prior consideration of the concepts of reverse auctions found that there was potential in reverse auctions as a market-based approach to determining universal service support, but found that the record was insufficient to support adoption of any particular competitive bidding mechanism. The Northwest Associations believe that there are a number of very serious issues that must be addressed before any competitive bidding[2] mechanism can be moved forward. These Opening Comments will endeavor to identify at least some of the core concerns.

COMMENTS AND QUESTIONS

1. The Overall Appropriateness of the Use of Reverse Auctions.

In paragraph 4 of the Public Notice, the Joint Board made the following opening statement:

> Generally, proposals to use auctions in the universal service context contemplate competitive bidding for the obligation to serve a specified area at an acceptable quality of service for a specified term, with the benefit of receiving universal service support to do so. By limiting the number of supported networks in each area and selecting the most cost-effective proposal(s), auctions could minimize the burden on consumers providing the support. The winning network provider(s) would receive support subject to reasonable service performance and service area coverage requirements.

[2] The terms "reverse auctions" and "competitive bidding" are used interchangeably.

The Joint Board then called for comments on the overall appropriateness of reverse auctions. The Public Notice asks the question of whether more than just price should be used to determine the winner of a competitive bid.[3] The Northwest Associations agree that if a competitive bid process is adopted, it is very important that more than price be used. The reasons for using more than just price are discussed in later portions of these Opening Comments.

Attached to the Public Notice is a Discussion Proposal. In that Discussion Proposal, the concept that is set out is that entities could bid for contracts for ten year terms to provide service in a particular area. In addition, the Discussion Proposal suggested that incumbent wireline ETCs could opt to be declared the initial ten year "winner" and receive their current level of support, adjusted for inflation. These Opening Comments will discuss competitive bidding concepts in light of this Discussion Proposal, although the comments are generally applicable to any competitive bidding proposal.

2. A Ten Year Term is Inconsistent with Existing Investment Recovery Lives and Loan Terms.

The first question that is raised about a ten year contract is whether the term would constitute the provision of support that is specific, predictable and sufficient pursuant to 47 U.S.C. §254(b)(5). A major question is raised related to the issues of predictability and sufficiency. For example, if the threat looms that in ten years or less a carrier may lose support upon which at least a portion of the carrier's investment recovery is predicated, then the goals of sufficiency and predictability are compromised. Further, the basis for these concerns of predictability and sufficiency is that a ten year term does not comport with the current regulatory and accounting view of how to measure the life of outside plant.

[3] Public Notice at ¶12.

Telecommunications networks require extensive investment in long-lived assets and infrastructure. In rural areas, the largest investment component is in outside plant. The very long loop lengths in rural areas are the driving factor. In many states, the depreciation life for outside plant approaches twenty years, not ten years.

In addition, many of the financing mechanisms for rural telecommunications infrastructure development such as the Rural Development Utility Program (formerly the Rural Utility Service), the National Rural Telecommunications Cooperative and CoBank ACB have loan terms in excess of ten years. These funding sources provide access to low cost capital that assists in the ability of rural companies to deploy telecommunications infrastructure, including broadband infrastructure. Would a reverse auction proposal that has a specific term, such as ten years, mean that all of these loan agreements would need to be rewritten so that the loans are paid off faster? Would a ten year term mandate faster depreciation rates and faster recovery of costs?[4]

It is possible that a ten year term will produce a significant increase, rather than decrease, in the deployment of high-cost funding, at least for the initial cycle of bidding.[5] The reason this could occur is that access to capital in rural markets is critical to meet the needs of the capital intensive telecommunications business, particularly for the deployment of broadband services. There are limited providers of capital for such markets. The three sources listed above are the primary providers of capital in rural telecommunications markets. If a large portion of the revenue stream that is used to repay those lenders becomes uncertain, rural companies may lose

[4] If the practical effect of ten year terms is to force new depreciation lives, this may be viewed as an impermissible attempt to preempt state commissions on the issue of depreciation.

[5] Presumably if outside plant cost is recovered in ten years, then the incumbent (the winner of the initial bid) would have a distinct advantage in calculating its bid for the second round of bidding. That is, the plant would still have a useful life in practical terms, but the cost of the plant would be recovered in full (assuming a static investment portfolio in which there is no new investment in plant in the interceding years).

their only source of capital. Certainly, the capital markets would require shorter loan terms, with higher interest rates, resulting in higher per line expenses in rural areas.

The effect that competitive bidding may have on availability or continuation of low-cost loan sources needs very careful evaluation. As noted above, it would only be sensible business for lenders in the rural telecommunications market to require shorter loan terms to coincide with the known availability of resources to pay those loans. Unless depreciation lives of plant are modified, it would become difficult for rural telephone companies to meet standard loan covenants. Without a reasonable expectation that capital will be recovered, rural investment will not be made and rural consumers will be deprived of advanced services.

A question arises throughout any consideration of the term of a ten year window whether there is the proper incentive to, for example, replace a failing switch in year seven or eight of a ten year term. There is some concern that any competitive bidding process would force band-aid approaches to service issues as the term begins to expire.

The Discussion Proposal suggests a sale at fair market value at the end of the term as a way of addressing issues such as un-recovered investment costs (stranded investment). However, the concept of mandated sale by regulation, whether at fair market value or otherwise, raises legal questions concerning the ability to condemn property, which is what such a mandated sale would amount to. There are also practical concerns. If the assets serving a particular area are only part of a larger system (for example, consisting of only outside plant that connects to a switch serving multiple areas) the mandated transfer of assets may have very little practical value.

3. The Geographic Scope of Bidding Raises Significant Issues.

The Public Notice solicited comment on how auctions could be designed to appropriately target support to areas in need of support. One of those issues is the choice of the appropriate geographic area for support. The Discussion Proposal is written in terms of support being provided on the county level.[6] The use of a "county" as the basis for determining support has the disadvantage of being capable of both understating and overstating the need for support, depending on how it is applied.

As an example of the use of a county to provide the basis for targeting support that would understate the need for support, it should be noted that there are many counties that have significant high-cost areas and significant low-cost areas within the same county. At one point in the past, comment was sought on the use of county density to target support. Specifically if a county was included in a metropolitan statistical area (MSA), rural company service areas in that county would be excluded from high-cost support. In states such as those represented by the Northwest Associations, counties are often quite large. There can be a very large metropolitan area in the county that has high density. Within the same county, some twenty miles or more away, there can be very low-density areas. The averaging effect of the high density area may mean on the surface the county looks relatively dense. However, in reality, there are large areas of very low density. Moreover, the densely populated portion of such a county may be served by one carrier, and the rural portions of the county may be served by one or more rural telephone companies.

Further, many states, such as Washington and Oregon, have adopted specific growth management standards that require counties with metropolitan areas to define urban growth areas

[6] The Discussion Proposal has a set of exceptions related to wireline incumbent providers. Those will be discussed below.

where high density can occur. Then, to preserve green space and amenities and avoid strip mall development, growth is not permitted outside of these urban growth areas. That means that areas outside the urban growth area might allow only one residence per ten acres or one residence per twenty acres. Those growth management policies produce low densities and high loop costs within a county that on average might be considered high density.

An illustration of this concern is provided in the State of Washington. Pierce County, Washington contains within it the City of Tacoma. Yet within that same county, growth is severely limited in the more rural portions of the county. These rural portions of the county make up the foothills around the north side of Mt. Rainier. Mashell Telecom, Inc. and CenturyTel of Washington both provide service to rural areas of Pierce County where density is limited by growth-management policies. These areas are today, and will probably remain for the foreseeable future, areas where densities are limited (very low) and the cost to serve will remain very high.

Oregon has some of the strictest growth management rules in the Nation. Another example of how use of county boundaries to determine the extent of support can understate the need for support comes from that state. The Portland-Vancouver-Beaverton Metropolitan Statistical Area (MSA), the 24th largest in the United States, has a population of 2,082,240 (2005 estimate) in about 550 to 600 square miles of urbanized land area. It consists of Multnomah, Washington, Clackamas, and parts of Columbia and Yamhill counties in Oregon, as well as Clark County, Washington. The area includes Portland and the neighboring cities of Beaverton, Gresham, Hillsboro, Milwaukie, Lake Oswego, Oregon City, Fairview, Wood Village, Troutdale, Tualatin and Tigard, as well as Vancouver, Washington. Clackamas County plays host to four rural companies that receive high-cost support. Combined, the four companies serve

a population of 17,000 in about 221 square miles of rural farming area. This means that on average the MSA has a population of 3,470 per square mile with the urban areas as high as 5,489 per square mile and rural, USF supported areas of the MSA at only 76 persons per square mile.[7] Averaging densities would deprive these rural areas of support.

Looking at the other side of the coin, the way in which the use of a county concept to target support can actually increase the high-cost fund is if the concept is used to allow support for rural areas currently served by Qwest and Verizon that do not receive support today. The way this could happen is as follows: Today support is calculated on a company service area basis. There are rural counties in Montana, Oregon and Washington where Qwest and Verizon provide service but receive little or no support today. If some version of a density test or per capita income test is used to qualify a county for high-cost support, this could actually result in a very substantial increase in the amount of high-cost support that would be required to be made available. When areas that are not receiving support today are opened for competitive bidding to provide support, the actual outcome, more probably than not, is that the total amount of support required will increase, not decrease. This concept needs very close scrutiny since it can work against the Joint Board's established objective of reducing or limiting the size of the USF.

4. The Public Notice is Not Clear on How to Evaluate Quality of Service Issues.

The Public Notice calls for comment on quality of service obligations and enforcement. Today, quality of service standards are established by each state for wireline providers. Often these are specifically referenced in the ETC process.[8] It is less clear how quality of service

[7] Census Bureau, 1990, 2000, PSU Population Reach Center, 2004, 2005; Office of Financial Management, State of Washington 2004, 2005.

[8] In the Matter of OREGON PUBLIC UTILITY COMMISSION Staff Investigation to Establish Requirements for Initial Determination and Recertification of Telecommunications Carriers Eligible to Receive Federal Universal Service Support, Docket No. UM 1217, Order No. 06-292. See, also, Montana ETC Designation Rules, ARM 38.5.3809(2)(d).

standards are established for wireless ETCs. Some states have adopted at least minimal wireless quality of service standards.[9] Others seem to take a hands-off approach to wireless providers.

In the Public Notice, the Discussion Proposal appears to suggest that quality of service standards would be established by contract. Would the contract for a state incorporate the existing wireline quality of service standards that would then apply to any auction winner? Would quality of service standards be subject to negotiation? Could quality of service vary by geographic area in a state depending upon who wins which auction? Would this lead to a reduction in the service level that customers would receive? Can WiFi technology qualify to bid? If so, what quality of service applies? Can satellite technology qualify to bid? If so, how does quality of service apply to a technology that has trouble working in snow, heavy rain, mountains and thickly forested areas such as that which occurs in areas served by the Northwest Associations' members? Quality of service concerns is one of the reasons to determine an auction winner on more than just price.

It appears to be a necessity that the quality of service standards be established in advance of the auction and be incorporated in the bid standards so that entities developing bids know the level of service that should be provided. Those quality of service standards would need to be detailed and precise. If there is only one winner in an auction, then the technology differences between wireline and wireless technologies would have to be incorporated into the quality of service standards. This could mean that wireless carriers would have to increase the reliability of their systems. Or, alternatively, this could mean that wireline systems would degrade in quality

[9] Illinois Valley Cellular RSA 2-1 Partnership Application for Designation as an Eligible Telecommunications Carrier for Purposes of Receiving Federal Universal Service Support Pursuant to Section 214(e)(2) of the Telecommunications Act of 1996 et al., Cause No. 04-0454, 04-0455, 04-0456, Order (April 19, 2006). See, e.g., Montana Public Service Commission Docket No. D2004.1.7, In the Matter of Sagebrush Cellular, Inc., Application for Designation as an Eligible Telecommunications Carrier, Final Order 6687a.

to provide a technological neutral base for a one-winner auction. Is the overall result of a competitive bid system that the states are preempted on quality of service issues?

5. Bidder Qualification.

One area, among many, that needs serious consideration is how an entity would qualify to bid. The lure of support money may bring many unqualified entities into the marketplace. The telecommunications industry is an exceedingly complex industry. Establishing the qualifications for bidding would require detailed bidding specifications on qualifications related to knowledge of technology, experience and other related standards. This raises a related issue to the minimum level of quality to be provided by the technology used. If competitive bidding goes into effect, it can be easily foreseen that entrepreneurs with no history of providing quality service will bid. For example, an operator of a string of wireless "hot spots" using unlicensed spectrum might attempt to qualify to bid. What standards will be used to qualify bidders?

6. The Role of Incumbent Carriers.

The Public Notice raises a number of questions related to the treatment of incumbent local exchange carriers that are serving as ETCs. Questions are raised in the Public Notice about how to avoid stranded investments. Questions are raised in the Public Notice on whether a transition period is needed. Questions are raised in the Public Notice about what happens to an incumbent's obligation to be carrier of last resort. The Discussion Proposal raises the idea that an incumbent could opt into being declared the "winner" of the initial auction and receive the initial ten year contract. Under this concept, the incumbent's high cost support would be frozen at the level the incumbent is receiving at the time of election, adjusted for inflation. While this concept has some attraction, it leaves open a number of questions.

Further, while again noting that providing the option for incumbents to be designated as winners for ten years with support indexed for inflation has merit, it should be kept in mind that many rural incumbent carriers today are investing in their networks to bring advanced services and additional options to their customers. Deploying broadband capabilities throughout America is a national goal, and one envisioned in the principles of universal service. The cost of such investment often exceeds the rate of inflation. If support is indexed only for inflation, without taking into account network investment, the result could be a disincentive for network investment.

An advantage of the Discussion Proposal's concept that the incumbent becomes the first auction winner upon election is that this proposal would mean the quality of service would remain at a high level for a good portion of the ten year window.

On the issue of stranded investment, the concern is what happens at the end of ten years. The Discussion Proposal raises the idea, but does not resolve it, that the assets would be purchased at fair market value. There are many different flavors of fair market value. As noted earlier, there are at least facially serious legal issues confronting this concept. In addition, it should not be assumed that the technologies would necessarily be compatible between the incumbent's technology and the "new" ETC's technology. Switching systems may not be compatible in terms of operation. Billing systems may be different. Can a system be easily transferred from one entity to another and provide service at the same level of acceptability if the hardware and software is transferred, but the people are not? Not every engineer is familiar with every type of switching technology. Not all customer service people are familiar with the handling back room systems and dealing with customer complaints in a particular state.

On the transition period issue, all of the questions and concerns raised earlier on the "term" issue apply to a transition.

The carrier of last resort issue is a difficult one. Often this is a question of state law. How would state law apply if an incumbent carrier in a very rural area loses the funding it needs to meet carrier of last resort obligations? Are the states to be preempted? More than the legal issues, there are practical issues concerning carrier of last resort concepts. The carrier of last resort concept is one of the reasons that just price alone is insufficient to determine the auction winner. The rural incumbent carriers have been meeting this obligation consistently and well for many, many years. The rural companies' focus has been to provide a uniform quality of service at a high level and to provide service wherever possible. In a "price only" competitive bidding regime, the financial incentives change. In particular, as the end of the term comes closer and closer, the financial incentive is to minimize extensions of service and to meet only the minimum level of quality of service given the uncertainty of being able to provide service in the future. The legal and practical effects of carrier of last resort obligations under an auction system needs further study.

CONSIDERATION OF ALTERNATIVES

The reverse auction concept is laudable as an effort to address the increasing size of the high-cost fund. However, there is a great deal of uncertainty about how such a concept would work in practice. At the very least, the Joint Board should consider other alternative solutions to controlling the size and growth of the high-cost fund such as the following:

- Remove the identical support rule as an effort to establish price/cost comparability and competitive neutrality.

- Explicitly limit the number of ETCs in an area.
- Consider separate wireline and wireless support mechanisms.

The costs and benefits of each of these options should be considered and compared to the costs and benefits of reverse auction.

CONCLUSION

At the core of the reverse auction concept is the assumption that consumers and service are fungible commodities. That is, that in any geographic area, X customers can be served by Y dollars and that competitive bidding will drive the X and Y axis to the point of intersection where the greatest number of customers can be served for the lowest number of dollars. However, it is often the intangibles; the willingness and desire to provide service that means the difference between high quality of service and indifference. It took over 100 years to build the public switched telecommunications network into what it is today. What is the risk that in short order reverse auctions would degrade, not enhance, that network and the quality of service received by customers? While in the short term the auction process might achieve a reduction in the size of the high-cost fund, it could also widen the digital divide and reduce the quality of service in rural areas.

There are a multitude of unanswered questions concerning the use of reverse auctions. However, one thing is clear. If questions are not clearly addressed up front, the result will be

years and years and years of litigation.

Respectfully submitted this 10th day of October, 2006.

Montana Telecommunications Association
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Washington Independent Telephone Association

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APPENDIX A

Montana Telecommunications Association

3 Rivers Telephone Cooperative
Blackfoot Telephone Cooperative
CenturyTel of Montana
Frontier Communications
Hot Springs Telephone Company
Lincoln Telephone Company
Range Telephone Cooperative

Oregon Telecommunications Association Small Company Committee

Asotin Telephone Company d/b/a TDS Telecom
Beaver Creek Cooperative Telephone Company
Canby Telephone Association
Cascade Utilities, Inc.
Citizens Telecommunications Company of Oregon d/b/a Frontier Communications of Oregon
Colton Telephone Company
Eagle Telephone System, Inc.
Gervais Telephone Company
Helix Telephone Company
Home Telephone Company d/b/a TDS Telecom
Molalla Communications, Inc.
Monitor Cooperative Telephone Company
Monroe Telephone Company
Mt. Angel Telephone Company
Nehalem Telecommunications, Inc.
North-State Telephone Co.
Oregon-Idaho Utilities, Inc.
Oregon Telephone Corporation
People's Telephone Co.
Pine Telephone System, Inc.
Pioneer Telephone Cooperative
Roome Telecommunications Inc.
St. Paul Cooperative Telephone Association
Scio Mutual Telephone Association
Stayton Cooperative Telephone Company
Trans-Cascades Telephone Company

Washington Independent Telephone Association

Asotin Telephone Company d/b/a TDS Telecom
CenturyTel of Cowiche
CenturyTel of Washington
Ellensburg Telephone Company d/b/a FairPoint Communications
Hat Island Telephone Company
Hood Canal Telephone Co., Inc.
Inland Telephone Company
Kalama Telephone Company
Lewis River Telephone Company, Inc. d/b/a TDS Telecom
Mashell Telecom, Inc. d/b/a Rainier Connect
McDaniel Telephone Co. d/b/a TDS Telecom
Pend Oreille Telephone Company
Pioneer Telephone Company
St. John Co-operative Telephone and Telegraph Company
Tenino Telephone Company
The Toledo Telephone Co., Inc.
Western Wahkiakum County Telephone Company
Whidbey Telephone Company
YCOM Networks, Inc. d/b/a FairPoint Communications